REPORT OF EXAMINATION
OF THE

COMMERCE WEST INSURANCE COMPANY

AS OF
DECEMBER 31, 2003

Participating State
and Zone:

California – Zone IV – Western

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San Francisco, California
July 1, 2004

Honorable Alfred W. Gross
Chairman of the NAIC Financial
Condition Subcommittee
Commissioner of Insurance
Virginia Bureau of Insurance
Richmond, Virginia

Honorable John Morrison
Secretary, Zone IV - Western
Commissioner of Insurance and Securities
Montana Department of Insurance
Helena, Montana

Honorable John Garamendi
Insurance Commissioner
California Department of Insurance
Sacramento, California

Dear Chairman and Commissioners:

Pursuant to your instructions, an examination was made of the

COMMERCE WEST INSURANCE COMPANY

(hereinafter also referred to as the Company) at its statutory home office and main administrative office, 5000 Hopyard Road, Suite 200, Pleasanton, California 94588.

SCOPE OF EXAMINATION

The previous examination of the Company was made as of December 31, 1999. This examination covers the period from January 1, 2000 through December 31, 2003. The examination was made pursuant to the National Association of Insurance Commissioners' (NAIC) plan of examination. California represented Zone IV – Western. The examination included a review of the Company's practices and procedures, an examination of management records, tests and analyses of detailed transactions within the examination period, and an evaluation of the assets and a determination of liabilities as of December 31, 2003, as deemed necessary under the circumstances.

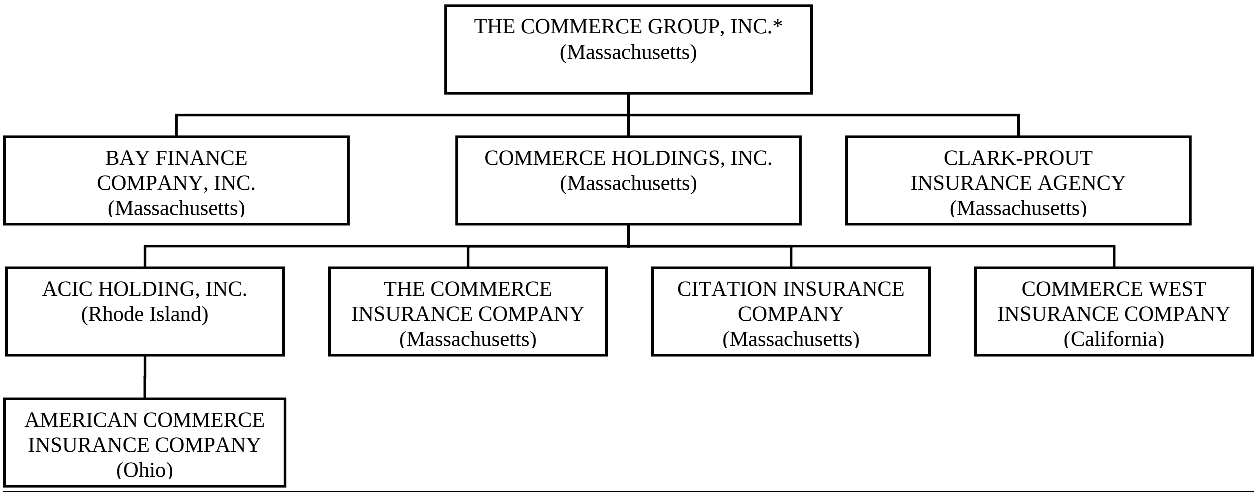
In addition to those items specifically commented upon in this report, other phases of the Company's operations were reviewed including the following areas that require no further comment: corporate records; fidelity bonds and other insurance; officers', employees' and agents' welfare and pension plans; growth of company; business in force by states; loss experience; and sales and advertising.

COMPANY HISTORY

On March 10, 2000, the Company changed its Articles of Incorporation to increase the par value of its common stock from $15 to $50. As a result, the Company's common capital stock increased from $1,000,005 to $3,333,350 through a transfer from unassigned funds. There were no dividends paid by the Company during the examination period.

MANAGEMENT AND CONTROL

The Company is a member of the Commerce Group, Inc., a publicly-traded company based in Massachusetts and the ultimate controlling entity. Four property-casualty companies are in the group, with the Company being the only one licensed in California. In December 2003, the Company became a first-level subsidiary of Commerce Holdings, Inc. through an internal holding company reorganization. Commerce Holdings, Inc. is wholly-owned by The Commerce Group, Inc., a publicly-traded Massachusetts corporation and the ultimate controlling entity. There was no change in control due to the reorganization. The following organizational chart depicts the relationship of the companies within the holding company system:



* All companies within The Commerce Group, Inc. are wholly-owned by their applicable parent company except for ACIC Holding, Inc. which is 95% owned by Commerce Holdings, Inc. and 5% by AAA Southern New England

Management of the Company is vested in a three-member board of directors. A listing of the members of the board and principal officers serving on December 31, 2003 follows:

Directors

Name and Residence	Principal Business Affiliation
Arthur J. Remillard Jr. Webster, Massachusetts	President Commerce Group, Inc.
Gerald Fels Dudley, Massachusetts	Chief Financial Officer Commerce Group, Inc.
Regan P. Remillard Boston, Massachusetts	Senior Vice President Commerce Group, Inc.

Principal Officers

Name	Title
Gerald Fels	President
James A. Ermilio	Secretary
Michael V. Vrban	Treasurer
Michael J. Berryessa	Vice President
Albert R. Harris	Vice President
John W. Hawie	Vice President

Management Services Agreement

The Company receives certain investment, management, financial reporting and tax-related services from its affiliate, Commerce Insurance Company, pursuant to a management services agreement. This agreement was approved by the California Department of Insurance (CDI) on December 9, 1999.

Cost-Sharing Arrangement

The Company has been operating under a cost-sharing arrangement whereby an employee of the Company performs services for both the Company and American Commerce Insurance Company (ACIC), an affiliate. The prior exam report indicated that there was no agreement supporting the allocation of expenses incurred by the Company to ACIC. It is recommended the Company formalize the arrangement by making the appropriate filings per California Insurance Code (CIC) Section 1215.5 in regards to cost-sharing arrangements.

Tax Allocation Agreement

The Company is party to a tax allocation agreement between The Commerce Group, Inc., its ultimate parent, and Commerce Holdings, Inc. (Holdings Affiliated Group), its direct parent company. Under the agreement, tax liability and credits are to be apportioned on a "separate return basis," whereby "separate return basis" means that the Holdings Affiliated Group is to be treated as a separate entity from Commerce Group, Inc. The agreement is silent about how the apportionment of tax liability or tax credits is made within the Holdings Affiliated Group, of which the Company is a part. There was a similar comment in the prior examination report concerning this issue. It is recommended that the Company amend its tax allocation agreement to specifically allocate consolidated current and deferred income tax among all members of the group consistent with Statement of Statutory Accounting Principles (SSAP) 10. A revised agreement should be filed with the CDI in accordance with CIC Section 1215.5(b)(4).

TERRITORY AND PLAN OF OPERATION

As of December 31, 2003, the Company was licensed to transact insurance in the states of Arizona, California, Oregon and Washington. Approximately 90 percent of the Company's 2003 direct business of $53,165,599 was written in California, with the remainder in Oregon. No policies have been issued yet in the states of Arizona or Washington. The Company primarily writes private passenger auto liability and physical damage on a preferred basis, with non-standard and commercial auto representing a smaller, but growing segment. The Company also wrote a small amount of general liability coverage on gardeners under the other liability line. The following schedule details the Company's 2003 direct and net premiums written by line of business:

Line of Business	Direct Premiums Written	Net Premiums Written
Other Liability – Occurrence	$ 61,262	$ 61,262
Private Passenger Auto Liability	26,992,239	26,975,581
Commercial Auto Liability	6,124,578	5,846,771
Auto Physical Damage	19,987,520	19,903,341
Totals	$53,165,599	$52,786,955

All business is written through approximately 800 independent agents in California and Oregon.

REINSURANCE

Assumed

The Company assumed no reinsurance during the examination period.

Ceded

The Company has two casualty excess of loss contracts with Swiss Reinsurance America Corporation (Swiss Re), an admitted reinsurer. The first contract provides auto liability and collision coverage of $500,000 excess of the Company's retention of $500,000. Since its personal auto programs are only written with liability limits up to $500,000, this contract serves to cover the commercial program only. The second contract covers all four insurers in the Commerce group. Following are the reinsurance limits and retentions as of the examination date:

Business Covered	Company Retention	Reinsurer’s Maximum Limits
Auto liability and auto collision	Effective 5/1/2000: $500,000 per loss occurrence	$500,000 excess of $500,000
Auto liability, auto collision and other liability	Effective 1/1/2003: $2 million per loss occurrence	1st Layer - $3 million excess of $2 million 2nd Layer - $5 million excess of $5 million

The Company’s reinsurance agreement effective May 1, 2000 was not in compliance with the California Insurance Code (CIC) Section 922.2(a)(2) in regards to the offset and insolvency clauses. Both of the Company’s reinsurance agreements did not meet National Association of Insurance Commissioners (NAIC) Statements of Statutory Accounting Principles (SSAPs) with respect to the termination provision. It is recommended that the Company revise these agreements to comply with California laws and the NAIC SSAPs.

ACCOUNTS AND RECORDS

A review was made of the Company's general information systems controls. Process and procedural weaknesses were noted in the following areas:

- IT strategic planning
- Periodic review of IT goals
- Disaster recovery and contingency planning
- Security policies and procedures
- User password controls

The management of the Company has stated that it has implemented or is in the process of implementing procedures to correct most of the deficiencies. The Company also stated that the Internal Audit Department of its affiliate will be performing periodic reviews of the Company's information systems controls in the near future. It is recommended that the Company continue to work towards improving the weaknesses noted in its information systems controls.

FINANCIAL STATEMENTS

The financial statements prepared for this examination report include:

Statement of Financial Condition as of December 31, 2003

Underwriting and Investment Exhibit for the Year Ended December 31, 2003

Reconciliation of Surplus as Regards Policyholders from December 31, 1999
through December 31, 2003

Statement of Financial Condition
as of December 31, 2003

Assets	Ledger and Nonledger Assets	Nonadmitted Assets	Net Admitted Assets	Notes
Bonds	$38,838,113	$	$38,838,113	
Preferred stocks	18,400,350		18,400,350	
Real estate:				
Properties occupied by the company	1,124,608		1,124,608	
Cash and short-term investments	9,418,985		9,418,985	
Receivable for securities	279,027		279,027	
Investment income due and accrued	567,401		567,401	
Premiums and considerations:				
Uncollected premiums and agents' balances in the course of collection	2,003,090	93,948	1,909,142	
Deferred premiums, agents' balances and installments booked but deferred and not yet due	4,461,490		4,461,490	
Net deferred tax asset	1,597,574		1,597,574	
Electronic data processing equipment and software	67,197		67,197	
Aggregate write-ins for other than invested assets	166,011	161,211	4,800	
Total assets	$76,923,846	$ 255,159	$76,668,687	

Liabilities, Surplus and Other Funds

Losses		$15,951,081	(1)
Loss adjustment expenses		4,692,483	(1)
Commissions payable, contingent commissions and other similar charges		779,101	
Other expenses (excluding taxes, licenses and fees)		1,278,370	
Taxes, licenses and fees (excluding federal and foreign income taxes)		167,266	
Current federal and foreign income taxes		3,254,064	
Unearned premiums		15,141,868	
Ceded reinsurance premiums payable		115,493	
Remittances and items not allocated		87,364	
Payable to parent, subsidiaries and affiliates		174,840	
Aggregate write-ins for liabilities		93,738	
Total liabilities		41,735,668	
Common capital stock	$ 3,333,350		
Gross paid-in and contributed surplus	10,480,965		
Unassigned funds (surplus)	21,118,704		
Surplus as regards policyholders		$34,933,019	
Total liabilities, surplus and other funds		$76,668,687	

Underwriting and Investment Exhibit for the Year Ended December 31, 2003

Statement of Income

Underwriting Income		
Premiums earned		$51,048,711
Deductions:		
Losses incurred	$28,182,767	
Loss expenses incurred	6,731,690	
Other underwriting expenses incurred	14,675,628	
Total underwriting deductions		49,590,085
Net underwriting gain		1,458,626
Investment Income		
Net investment income earned	$ 3,384,661	
Net realized capital gains	1,889,951	
Net investment gain		5,274,612
Other Income		
Aggregate write-ins for miscellaneous income	$ 1,602,108	
Total other income		1,602,108
Net income before federal income taxes		8,335,346
Federal income taxes incurred		3,232,859
Net income		$ 5,102,487

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2002		$27,983,700
Net income	$ 5,102,487	
Change in net unrealized capital gains	1,345,877	
Change in net deferred income tax	153,845	
Change in nonadmitted assets	340,676	
Aggregate write-ins for gains in surplus	6,434	
Change in surplus as regards policyholders for the year		6,949,319
Surplus as regards policyholders, December 31, 2003		$34,933,019

Reconciliation of Surplus as Regards Policyholders
from December 31, 1999 through December 31, 2003

	Gain in Surplus	Loss in Surplus	
Surplus as regards policyholders, December 31, 1999, per Examination			$23,130,817
Net income	$ 4,666,259	$	
Change in net unrealized capital gains	3,269,033		
Change in net deferred income tax	886,060		
Change in nonadmitted assets	662,371		
Change in excess of statutory reserves over statement reserves	1,722,430		
Cumulative effect of changes in accounting principles	559,601		
Capital change: Transferred from surplus		2,333,345	
Capital change: Transferred to capital	2,333,345		
Aggregate write-ins for gains in surplus	36,448		
Total gains and losses	$14,135,547	$ 2,333,345	
Increase in surplus as regards policyholders			11,802,202
Surplus as regards policyholders, December 31, 2003, per Examination			$34,933,019

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Losses and Loss Adjustment Expenses

The Company's reserves for losses and loss adjustment expenses were reviewed by a California Department of Insurance Casualty Actuary and found to be reasonable.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

Management and Control – Cost Sharing Arrangement (Page 4): It is recommended that a written management or service agreement be made to support the allocation arrangement between the Company and its affiliate, American Commerce Insurance Company, and that the agreement be submitted to the California Department of Insurance (CDI) for approval.

Management and Control – Tax Allocation Agreement (Page 4): It is recommended that the tax allocation agreement be revised and that the revised agreement be submitted to the CDI for approval.

Reinsurance (Page 6): It is recommended the Company amend its reinsurance agreements to comply with California laws and the NAIC Statements of Statutory Accounting Principles.

Accounts and Records (Page 7): It is recommended that the Company continue to work towards improving the weaknesses noted in its information systems controls.

Previous Report of Examination

Management and Control – Management Agreement (Page 3): It was recommended that a written management or service agreement be made to support the allocation arrangement that the Company has with its affiliate, American Commerce Insurance Company, and that the agreement be submitted to the CDI for approval. The Company did not comply.

Management and Control – Management Agreement (Page 3): It was recommended that the tax allocation agreement be revised and submitted to the CDI for approval. The Company did not comply.

Management and Control – Conflict of Interest (Page 5): It was recommended that the Company require declarations of conflict of interest statements by its directors, officers and key employees and monitor compliance with the conflict of interest policy. The Company has complied.

Corporate Records (Page 5): It was recommended that investment transactions be authorized or approved by the board of directors per California Insurance Code (CIC) Section 1200. The entry of approval must comply with CIC Section 1201. The Company has complied.

Reinsurance – Ceded (Page 6): It was recommended that the Company amend its reinsurance agreement to comply with California laws and Chapter 22 of the NAIC Accounting Practices and Procedures Manual. The Company did not comply.

Comments on Financial Statement Items – Agents' Balances or Uncollected Premiums (Page 12): It was recommended that the Company age the new and renewal business, including endorsements, based on the effective date of the policy or endorsements. On installment premiums, ageing should be based on the contractual due date of the installment. The Company has complied.

Comments on Financial Statement Items – Taxes, Licenses and Fees (Page 12): It was recommended that the Company pay the additional premium taxes due the State of California in the amount of $3,991. The Company has complied.

ACKNOWLEDGEMENT

The courtesy and cooperation extended by the Company's officers and employees during the course of this examination are hereby acknowledged.

Respectfully submitted,

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Isabel Spiker, CFE
Examiner-In-Charge
Senior Insurance Examiner
Department of Insurance
State of California